

EXECUTIVE SUMMARY

This Report, required by §8305(6), Title 29, Delaware Code, assesses the impact of tax preferences on the personal income tax, corporate income tax, motor fuel/special fuel tax, and public utility tax codes.

Tax preferences are no different from additional state spending in terms of their budgetary implications and thus are sometimes referred to as "tax expenditures." A reduction in revenues has the same fiscal impact as a direct expenditure of equal magnitude -- both consume finite public resources. Since the last Tax Preference Report was issued in 2005, Delaware has created two new tax preferences and eliminated three, bringing the total covered by this report to 44. The growth in State expenditures on tax preferences, however, has continued to increase.

Tax preferences are often established to pursue public policies that are not directly related to the tax system itself. For example, the tax-exempt status of employer-provided health insurance is primarily a health care policy that is administered through the tax system. In these cases, the effectiveness of a tax preference should be subject to the same cost-benefit analysis that direct expenditures undergo.

Using cost-benefit analysis to evaluate tax preferences is more difficult than for comparable direct expenditures. The analysis must also weigh how the policy affects the tax system through which it operates. For example, the impacts of such policies are often in conflict with the goals of an "ideal" tax system. The proliferation of tax preferences can, if left unchecked, undermine the fairness of a tax system, erode the tax base, distort private economic incentives, and generate unnecessary complexity within the tax code.

Given their budgetary and policy equivalence to direct expenditures, the burden they may place on the tax system, and the upward trend in their use, tax preferences represent a significant component of Delaware's fiscal environment. As such, it is important that this report receive serious attention from State policy makers.

ACKNOWLEDGMENTS

James Craig and Rebecca Goldsmith, of the Department of Finance's Office of Research and Analysis, performed the preponderance of analysis used in this Report.

The Division of Revenue also appreciates the assistance, analysis and contributions of the staff of the Delaware Economic Development Office, Department of Natural Resources and Environmental Control, Delmarva Power Delivery, Motor Fuel Tax Administration, the Delaware Transit Corporation and the State Lottery Office.

The revenue estimates and judgments expressed herein, however, are ultimately those of the Division of Revenue.

Patrick Carter
Director of Revenue

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